

FEDERAL RESERVE SYSTEM

Frost Bank
San Antonio, Texas

Order Approving the Establishment of Branches

Frost Bank, a state member bank subsidiary of Cullen/Frost Bankers, Inc. (“Cullen/Frost”), both of San Antonio, Texas, has requested the Board’s approval under section 9 of the Federal Reserve Act (“FRA”)¹ and the Board’s Regulation H² to establish two branches in Texas.³

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in accordance with the Board’s Rules of Procedure.⁴ The time for submitting comments has expired, and the Board has considered the proposal and all comments received in light of the factors specified in the FRA.

Cullen/Frost is the sixth largest depository organization in Texas with 136 offices throughout Texas, controlling approximately \$23.9 billion in deposits, which represent approximately 3.3 percent of the total amount of deposits of insured depository

¹ 12 U.S.C. § 321.

² 12 CFR Part 208.

³ Frost Bank proposes to establish one branch at 314 South WW White Road, San Antonio (the “San Antonio Branch”), and one branch at 2421 East Seventh Street, Austin, Texas (the “Austin Branch”).

⁴ 12 CFR 262.3(b).

institutions in that state.⁵ Frost Bank operates only in Texas, and the bank's main office is in San Antonio, Texas.

Under section 208.6 of the Board's Regulation H, which implements section 9 of the FRA,⁶ the factors that the Board must consider in acting on branch applications include (1) the financial history and condition of the applying bank and the general character of its management; (2) the adequacy of the bank's capital and its future earnings prospects; (3) the convenience and needs of the community to be served by the branch; (4) in the case of branches with deposit-taking capability, the bank's performance under the Community Reinvestment Act ("CRA");⁷ and (5) whether the bank's investment in bank premises in establishing the branch satisfies certain criteria.⁸

The Board has considered the applications in light of these factors and the public comment received on the proposal. One commenter objects to the proposal, alleging that Frost Bank discriminates against African Americans and "redlines" African American neighborhoods, particularly in the Dallas and Houston areas, both in Texas, with respect to its branching, marketing, and lending activities.⁹

Financial, Managerial, and Other Supervisory Considerations

In considering the financial history and condition, earnings prospects, and capital adequacy of Frost Bank, the Board has reviewed reports of examination, other supervisory information, publicly reported and other financial information, information provided by Frost Bank, and the comment received. Frost Bank is well capitalized and

⁵ Data are as of June 30, 2015. In this context, insured depository institutions include commercial banks, savings and loan associations, and savings banks.

⁶ 12 CFR 208.6(b).

⁷ 12 U.S.C. § 2901 *et seq.*

⁸ 12 CFR 208.21(a).

⁹ Redlining is the practice of denying a creditworthy applicant a loan or service in a certain neighborhood even though the applicant may otherwise be eligible for the loan or service.

would remain so upon consummation of the proposal. After considering all the facts of record, the Board concludes that the financial history and condition, capital adequacy, and future earnings prospects of Frost Bank are consistent with approval of the proposal. The Board also has reviewed Frost Bank's proposed investment in the branches and concludes that its investment is consistent with regulatory limitations on investment in bank premises.¹⁰

In considering Frost Bank's managerial resources, the Board has reviewed the bank's examination record, including assessments of its management, risk-management systems, and operations. The Board also has considered its supervisory experiences with Frost Bank and the bank's record of compliance with applicable banking laws, including anti-money-laundering laws. Frost Bank is considered to be well managed. Based on this review and all the facts of record, the Board concludes that Frost Bank's management, as well as the effectiveness of Frost Bank in combatting money-laundering activities, are consistent with approval of the proposal.

Convenience and Needs Considerations

In considering the effects of the proposal on the convenience and needs of the communities to be served, the Board considers whether the relevant institution is helping to meet the credit needs of the communities it serves, as well as other potential effects of the proposal on the convenience and needs of the communities to be served.¹¹ In this evaluation, the Board places particular emphasis on the record of the relevant depository institution under the CRA. The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation,¹² and requires the appropriate federal financial supervisory agency to

¹⁰ 12 CFR 208.21(a).

¹¹ 12 CFR 208.6(b)(3).

¹² 12 U.S.C. § 2901(b).

assess a depository institution's record of helping to meet the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods.¹³

In addition, the Board considers the bank's overall compliance record and recent fair lending examinations. Fair lending laws require all lending institutions to provide applicants with equal access to credit, regardless of their race, ethnicity, or certain other characteristics. The Board also considers assessments of other relevant supervisors, the supervisory views of examiners, other supervisory information, information provided by the applicant, and comments received on the proposal. The Board also may consider the institution's business model, its marketing and outreach plans, the organization's plans after consummation, and any other information the Board deems relevant.

In assessing the convenience and needs factor in this case, the Board has considered all the facts of record, including reports of examination of the CRA performance of Frost Bank, the fair lending and compliance records of the bank, confidential supervisory information, information provided by Frost Bank, and the public comment received on the proposal. As noted above, a commenter objects to the proposal, alleging that Frost Bank has engaged in discriminatory practices in Houston and Dallas, both in Texas. In particular, the commenter alleges that Frost Bank disfavors certain African American neighborhoods in Houston and Dallas and has limited its lending, marketing activities, community development activities, and branching in those neighborhoods.

Frost Bank denies the commenter's allegations, arguing that it has received a "Satisfactory" rating in its most recent CRA performance evaluation. Frost Bank asserts that the allegations regarding alleged discriminatory activities in Houston are substantially similar to allegations made in 2013 and 2014 by the same commenter in connection with the applications by Cullen/Frost and Frost Bank to acquire WNB

¹³ 12 U.S.C. § 2903.

Bancshares, Inc., and to merge with Western National Bank,¹⁴ both of Odessa, Texas (the “WNB Applications”). In acting on those applications, the Board considered the commenter’s allegations and determined that they did not preclude approval of the proposed acquisition.¹⁵ In the Dallas area, Frost Bank contends that it has recently opened branches that directly contribute to serving the needs of majority-minority census tracts. In addition, Frost Bank represents that the proposed Austin and San Antonio branches also would directly serve majority-minority tracts.

Records of Performance Under the CRA

As indicated above, in evaluating the convenience and needs factor and CRA performance, the Board considers substantial information in addition to information provided by commenters and the response to comments by the applicant. In particular, the Board evaluates an institution’s performance in light of examinations and other supervisory information and information and views provided by the appropriate federal supervisors.¹⁶

The CRA requires that the appropriate federal financial supervisor for a depository institution prepare a written evaluation of the institution’s record of helping to meet the credit needs of its entire community, including LMI neighborhoods.¹⁷ An institution’s most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation by the institution’s primary federal supervisor of the institution’s overall record of lending in its communities.

¹⁴ Cullen/Frost Bankers, Inc., FRB Order No. 2014-10 (May 14, 2014) (“Cullen/Frost Order”).

¹⁵ In connection with the Board’s action on the WNB Applications, Cullen/Frost provided commitments to the Board related to the compliance and fair lending programs of Cullen/Frost and Frost Bank. These commitments are discussed further below.

¹⁶ See Interagency Questions and Answers Regarding Community Reinvestment, 75 Federal Register 11642, 11665 (March 11, 2010).

¹⁷ 12 U.S.C. § 2906.

In general, federal financial supervisors apply lending, investment, and service tests to evaluate the performance of a large insured depository institution in helping to meet the credit needs of the communities it serves. The lending test specifically evaluates the institution's home mortgage, small business, small farm, and community development lending to determine whether the institution is helping to meet the credit needs of individuals and geographies of all income levels. As part of the lending test, examiners review and analyze an institution's data reported under the Home Mortgage Disclosure Act of 1975 ("HMDA"),¹⁸ in addition to small business, small farm, and community development loan data collected and reported under the CRA regulations, to assess an institution's lending activities with respect to borrowers and geographies of different income levels. The institution's lending performance is based on (1) the number and amount of home mortgage, small business, small farm, and consumer loans (as applicable) in the institution's assessment areas; (2) the geographic distribution of such loans, including the proportion and dispersion of the institution's lending in its assessment areas and the number and amount of loans in low-, moderate-, middle-, and upper-income geographies; (3) the distribution of such loans based on borrower characteristics, including the number and amount of home mortgage loans to low-, moderate-, middle-, and upper-income individuals;¹⁹ (4) the institution's community development lending, including the number and amount of community development loans and their complexity and innovativeness; and (5) the institution's use of innovative or flexible lending practices to address the credit needs of LMI individuals and geographies.

¹⁸ 12 U.S.C. § 2801 et seq.

¹⁹ Examiners also consider the number and amount of small business and small farm loans to businesses and farms with gross annual revenues of \$1 million or less, small business and small farm loans by loan amount at origination, and consumer loans, if applicable, to low-, moderate-, middle-, and upper-income individuals. See, e.g., 12 CFR 228.22(b)(3).

CRA Performance of Frost Bank

Frost Bank was assigned an overall “Satisfactory” rating at its most recent CRA performance evaluation by the Federal Reserve Bank of Dallas (“Reserve Bank”), as of May 13, 2013 (“Frost Bank Evaluation”).²⁰ Frost Bank received a “High Satisfactory” rating for the Lending Test, an “Outstanding” rating for the Investment Test, and a “High Satisfactory” rating for the Service Test.²¹

Examiners found that Frost Bank’s overall lending activity in its assessment areas was good and that Frost Bank made a substantial majority of its loans inside its assessment areas. According to examiners, the bank’s geographic distribution of HMDA and small business lending reflected excellent penetration in LMI geographies. Examiners also found that the bank had an excellent overall distribution of loans among borrowers of different income levels and business customers of different sizes. Examiners noted that the bank made an adequate level of community development loans during the review period. Frost Bank’s community development loans were made for a variety of purposes, but the majority of loans were for the purpose of providing community services to individuals or LMI areas and for affordable housing.

²⁰ The Frost Bank Evaluation was conducted using Large Bank CRA Examination Procedures. The evaluation period for the Lending Test was from January 1, 2010, through December 31, 2011, except for community development loans, which had an evaluation period from August 8, 2008, through December 31, 2011. The evaluation period for the Investment Test and the Service Test was from August 8, 2008, through December 31, 2011.

²¹ The Frost Bank Evaluation included a full-scope review of the bank’s assessment areas within the following Metropolitan Statistical Areas (“MSAs”): the Austin–Round Rock–San Marcos, Texas, MSA; the Dallas–Plano–Irving, Texas, Metropolitan Division (“Dallas AA”); the Fort Worth–Arlington, Texas, Metropolitan Division; the Houston–Sugar Land–Baytown, Texas, MSA (“Houston AA”); and the San Antonio–New Braunfels, Texas, MSA (“San Antonio AA”). A limited-scope review was conducted in the bank’s assessment areas within the Brownsville–Harlingen, Texas, MSA; the Corpus Christi, Texas, MSA; and the McAllen–Edinburg–Mission, Texas, MSA, as well as in the Willacy County, Texas, assessment area.

In the Houston AA, an area where the commenter focused, Frost Bank exhibited good lending performance. The bank's lending activity reflected good responsiveness to assessment area credit needs, and the bank's geographic distribution of loans reflected excellent penetration throughout the assessment area. The bank's distribution of borrowers reflected good penetration among borrowers of different income levels and businesses of different revenue sizes. Frost Bank made a relatively high level of community development loans in the assessment area.

In the Dallas AA, another area of concern to the commenter, Frost Bank showed good lending performance. The bank's lending activity reflected adequate responsiveness to assessment area credit needs, and the bank's geographic distribution of loans reflected good penetration throughout the assessment area. The bank's distribution of borrowers reflected good penetration among borrowers of different income levels and businesses of different revenue sizes. Frost Bank made a low level of community development loans in the assessment area.

Examiners found that Frost Bank had an excellent level of qualified community development investments and grants in its assessment areas.²² Examiners noted that Frost Bank's investments demonstrate excellent responsiveness to the most pressing credit and community development needs throughout its assessment areas. Frost Bank invested in small business investment companies, purchased mortgage-backed securities issued by the Government National Mortgage Association, and invested in mortgage revenue bonds issued by the Texas Department of Housing & Community Affairs that are targeted to LMI individuals.

In the Houston and Dallas AAs, Frost Bank's performance on the Investment Test was excellent. Frost Bank exhibited excellent responsiveness to credit

²² Frost Bank's performance in the San Antonio AA had the greatest impact on the Investment Test due to a higher concentration of deposits, branches, and combined HMDA and CRA small business lending than the other assessment areas.

and community development needs through its investment activities in these assessment areas, which included investments for affordable housing.

Examiners noted that Frost Bank's retail delivery systems were reasonably accessible to the geographies and individuals of different income levels. Examiners further noted that Frost Bank's opening and closing of branches did not adversely affect the accessibility of banking services to LMI geographies and that the banking services and business hours did not vary in a way that inconvenienced any portion of the bank's assessment areas, particularly LMI geographies and individuals. Examiners also noted that Frost Bank offered no- or low-cost deposit accounts and various alternative delivery systems. Examiners indicated that the bank overall was a leader in providing community development services that benefit LMI residents and small businesses of the assessment areas. Examiners noted that the bank's directors, officers, and staff members were involved in numerous organizations and activities that promote or facilitate affordable housing for LMI individuals, services for LMI individuals, and economic development and revitalization of LMI areas and were involved in financial literacy outreach efforts.

In the Houston and Dallas AAs, Frost Bank's performance on the Service Test was good. The bank's retail and community development services reflected good responsiveness to the needs of these assessment areas. The bank's delivery systems were reasonably accessible to the bank's geographies and to individuals of different income levels in these assessment areas. In the Dallas AA, Frost Bank was a leader in providing community development services; in the Houston AA, the bank provided a relatively high level of community development services.

Frost Bank's Efforts Since the 2013 CRA Evaluation

Frost Bank represents that, since the Frost Bank Evaluation, it has continued to help meet the credit needs of its assessment areas, including the needs of LMI communities and individuals within these areas. Frost Bank has made community development loans that promote affordable housing and that support organizations providing community services. Frost Bank has continued to purchase mortgage-backed securities secured by mortgage loans made to LMI borrowers and, since 2012, has made

community development investments in school bonds that fund economically disadvantaged school districts throughout Texas. Frost Bank has made donations to support CRA-qualified nonprofit organizations or other entities providing community development services in each of its assessment areas. Frost Bank has continued to provide a low-cost checking account and low-cost unsecured and secured home improvement loans for LMI individuals. The bank has provided financial education for youths, adults, and seniors and, beginning in 2013, has conducted educational events for LMI homeowners on home improvement, home improvement loan options, and the availability of utility bill assistance.

The Reserve Bank began a CRA examination of Frost Bank in the third quarter of 2015. Overall, examiners found that Frost Bank's CRA performance remained satisfactory, including in the Houston and Dallas AAs.²³

As noted above, in 2014, in connection with the Board's action on the WNB Applications, Cullen/Frost committed not to engage in any expansionary activities, including branching within its existing market areas, until such time that the Board has deemed Cullen/Frost to have clearly developed a policy to support future expansion in its compliance program, including fair lending, and to hire additional staff with requisite knowledge and experience to manage and control the bank's fair lending risk, which might be heightened by expansion (the "Commitments").²⁴ Under the Commitments, Cullen/Frost may apply to establish branches within existing market areas if the proposed branch would directly contribute to serving the needs of majority-minority census tracts.

Consistent with the Commitments, the proposed branches would increase the availability of banking services in minority neighborhoods. Both of the proposed branches would be located in low-income, majority-minority census tracts. Four of the six census tracts surrounding the census tract that would contain the Austin Branch are

²³ The review period for the Lending Test, Investment Test, and the Service Test was January 1, 2012, through December 31, 2014.

²⁴ Cullen/Frost Order at 19 n.33. The commenter alleged that Cullen/Frost and Frost Bank are not in compliance with the Commitments.

LMI tracts, and five of these are majority-minority census tracts. In the case of the San Antonio Branch, four of the seven census tracts surrounding the census tract that would contain the branch are LMI tracts, and all are majority-minority census tracts.

Cullen/Frost and Frost Bank have made improvements to the bank's compliance program, particularly its fair lending program. Frost Bank represents that the bank has strengthened its board and senior manager oversight of compliance, fair lending, and CRA risks. The bank has expanded its electronic fair lending data collection and conducts regular analyses to assess and monitor fair lending risks and trends. In addition, the bank has added staff in its Compliance Department and has increased the number of analysts that conduct fair lending analyses and manage fair lending data.

As part of the bank's wider marketing and branching efforts, Frost Bank has implemented plans to help serve the needs of historically underserved neighborhoods, focusing on majority-minority census tracts. Frost Bank has developed a marketing and outreach program designed to inform underserved individuals and communities of credit availability, increase outreach efforts with neighborhood groups in all of the bank's market areas, and target minority publications to increase lending to underserved individuals and communities. Frost Bank also has developed a branch strategy to help serve the credit needs of majority-minority areas. All of Frost Bank's branching activities proposed after entering into the Commitments have contributed to servicing the needs of minority neighborhoods in the bank's existing market areas; in 2015, Frost Bank established three new branches in the Dallas–Plano–Irving, Texas, Metropolitan Division, all of which were located in majority-minority census tracts.

Additional Convenience and Needs Considerations

The Board also considers other potential effects of the proposal on the convenience and needs of the communities to be served. As discussed above, the proposal would increase the availability of banking services in LMI and minority neighborhoods. Frost Bank proposes to offer its full array of products through each branch and to install an ATM at each branch to increase the availability of banking services at each location.

Conclusion on Convenience and Needs Considerations

The Board has considered all the facts of record, including the records of Frost Bank under the CRA, the bank's records of compliance with fair lending and other consumer protection laws, confidential supervisory information, information provided by Frost Bank, the public comment on the proposal, and other potential effects of the proposal on the convenience and needs of the communities to be served. Based on that review, the Board concludes that the convenience and needs factor is consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board determines that the applications should be, and hereby are, approved. The Board's approval is specifically conditioned on Frost Bank's compliance with all the commitments made to the Board in connection with the proposal as well as all conditions imposed in this order.²⁵ The conditions and commitments relied on by the Board are deemed to be conditions imposed in writing in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

Approval of these applications is also subject to the establishment of the proposed branches within one year of the date of this order, unless such period is extended by the Board or the Reserve Bank acting under authority delegated by the Board.

By order of the Board of Governors,²⁶ effective March 14, 2016.

Margaret McCloskey Shanks

Margaret McCloskey Shanks
Deputy Secretary of the Board

²⁵ This order does not grant relief from the Commitments.

²⁶ Voting for this action: Chair Yellen, Vice Chairman Fischer, and Governors Tarullo, Powell, and Brainard.